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The Rise and Fall of State Banking: Financial Market Politics in Postwar OECD Countries

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ABSTRACT

The Rise and Fall of State Banking:
Financial Market Politics in Postwar OECD Countries

State banking, defined as the intervention of the state in the allocation of credit, became important in some countries during the postwar era but not in others, and then more or less disappeared in the 1980s. The purpose of the article is to develop an explanation for longitudinal and cross-national variations in state banking for seventeen OECD countries. The paper argues that state banking was the unintended child of class politics; its subsequent demise is coterminous with the weakening of class politics and the reemergence of territorial politics. Competition between territorial jurisdictions is the normal mode of interest articulation and value redistribution in capital markets. Yet, the polarization of the party system along the class cleavage in countries where this party system was not dominated by one party, empowered categories of producers, who, under normal circumstances, would have been harmed by the play of market forces in the allocation of capital. They used this power to extract state banking. The progressive depolarization of all party systems stripped the small capitalists from their postwar leverage, and opened the way for the deregulation of state banking. The paper more generally argues that the current demise of state banking reflects the shift from class to territorial modes of interest articulation in capital markets and beyond.

The Rise and Fall of State Banking:

Financial Market Politics in Postwar OECD Countries

"A banker is a soldier in the service of the State."

Jean-Baptiste Colbert[1]

State banking is the direct intervention of the state in the allocation of credit. It is not to be confused with bank nationalization. Nationalization aims at redistributing bank profits. State banking, in contrast, aims at reallocating bank credit. State banking became important in some countries during the postwar era but not in others. State banking assumed considerable importance in Belgium, France, the Netherlands, Norway, and New Zealand, but remained of limited importance in Britain, Italy, Germany, Japan, Spain, and Sweden, and was insignificant in Denmark, Canada, Switzerland, and the United States. The purpose of this study is to investigate what accounts for this peculiar variation.

Why study banking? Political scientists, with a few notable exceptions,[2] have traditionally neglected the study of banking. Comparative knowledge on how capital markets are organized, cleft, and of how distributive conflicts in that market are allocated, is scant.[3] Capital alternatively appears as an employer[4] or as the owner of fixed capital,[5] but rarely as plain cash. This

[1] Cited in Hu 1984:14.
[2] Zysman 1983; Loriaux 1991; Pérez 1997.
[3] The phrases "capital market" and "financial market" are used in this paper in reference to banks, not to equity markets. Equity markets, especially in Anglo-Saxon countries, are essentially second-hand markets, which contribute very little to new investment--between 1 and 10 percent depending on the OECD country. New investment is mainly self-financed or financed by banks.
[4] This is the central theme of the literature on party systems and on corporatism.
[5] Rogowski 1989. Frieden 1991. Alt and Gilligan 1994. Verdier 1994.

fact is reflected in the disproportionate interest lavished on the class cleavage, the defining cleavage of all labor markets, and, throughout most of this century, most party systems[6]; it is also reflected in the strong emphasis put on the sectoral cleavage, the defining cleavage of all vested capital involved in lobbying for a tariff or an exchange rate[7]; it is finally reflected in the lack of interest for the territorial cleavage, which is more typical of financial markets. Distributive conflicts in financial markets are usually territorial because cash, unlike labor and machinery, is inherently mobile, and mobility forces neighboring geographic entities, be they *régions*, *landsleden*, *Kanton*, *Länder*, provinces, States, or nation states, to vie for this factor of production.[8]

There are imminent signs, however, that the class and sectoral cleavages are losing ground to the territorial cleavage. "Globalization," a general term referring to the fact that capital has become more mobile, both within and between countries, is making domestic financial markets central again in the allocation of gains and losses. Broader market openness and greater central bank independence, by removing opportunities of lobbying for tariffs and currency undervaluation, are putting the sectoral cleavage out of business, literally so.[9] The class cleavage--still the defining cleavage of most party systems--is losing relevance to its traditional rival. Local communities are increasingly active in the competition for investment, irrespective of partisan color.[10] Tasks until now assumed by national governments are either privatized to companies operating in global markets, decentralized to local

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[6] The literature is huge. See among others, Rokkan 1970, Bartolini and Mair 1990, and Bartolini's monumental study (1997).
[7] Frieden 1991. Frieden and Rogowski 1996.
[8] See Krugman 1993.
[9] Of course, changes in trade policy and monetary institutions are still fought along sectoral lines; see Eichengreen and Frieden 1994, Milner 1997.
[10] See, among others, Guisinger 1985 and Thomas forth.

governments, or delegated to regional, supranational entities (EU, NAFTA, ASEAN).[11] I will show that state banking, which appeared in the 1920s and flourished in the 1950s, was the unintended child of class politics; its subsequent demise is coterminous with the weakening of class politics and the reemergence of territorial politics.

Four explanations of state banking can be found in the admittedly-small comparative literature on postwar banking. The traditional view is that state banking is a functional response to a market failure. The idea was initially propounded by Alexander Gerschenkron (1962) in his account of Russian industrialization. The more capital was needed in the shortest amount of time, Gerschenkron argued, the less could private fortunes and equity markets cope with the task of allocating long-term financial capital; instead, banks had to step in. State banking, in Gerschenkron's argument, entered the picture as ultimate substitute for profit banking, would the latter prove unable to meet the demand for investment. Gerschenkron's argument has been faulted for two weaknesses: first, a functionalist causality, mistaking what in effect was a policy choice--high growth--for a constraint, and, second, case selection, overlooking governments that chose not to pursue a high-growth policy.

A second line of argument stresses the unique opportunities offered by American hegemony and the Cold War. Michael Loriaux (1991) argues that state banking in France was an instance of Hicks' "overdraft economy," in which private investment is bankrolled by the central bank. A string of weak French governments pursued full employment at the cost of inflation, passing on the negative effects to France's trade partners through recurring devaluations of the franc, under the pretext that any other policy might lead to a

[11] See Keating 1997.

strengthening of communism in France and elsewhere. The decline of American hegemony, but even more so the deliberate attempts by successive U.S. governments to stop that decline, removed the preconditions for state banking. Loriaux' argument carries the study of state banking beyond the limited notion of economic efficiency. State banking, in his work, is not just an efficient way of channeling capital to fast-growing sectors, but also a means of buying the political support of the sectors that are condemned by rapid industrialization. Loriaux' argument is also useful in understanding the universal demise of state banking.[12] However, no systemic variable can account for the cross-national variation in state banking. Indeed, why did only a handful of countries take advantage of American hegemony to create an overdraft economy?

A third line of argument underscores the importance of cross-national variations in domestic institutions. John Zysman (1983) attributed the existence of "state-directed, price-administered" financial system in France and Japan to the existence of a strong state. He contrasted the state-directed model with the Anglo-Saxon "market-based" model, and the German private-bank-organized credit market.[13] The weakness with this line of argument was best stated by Sofía Pérez (1997:169): "Like other work within the institutionalist literature, Zysman's typology was premised on the assumption that institutional attributes, reflecting national historical legacies, are relatively stable over time. Yet, this premise has been challenged by the unraveling of the cross-national pattern of regulatory divergence that Zysman captured."[14] Good at revealing cross-national variations, institutionalism offers no grip on historical change.

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[12] For an attempt to generalize parts of the argument to other national experiences, see Loriaux 1997.
[13] See also Shonfield 1965, and Hu 1984.
[14] In many ways, Zysman anticipated the criticism in the conclusion to his 1983 book.

In her own work, Sofía Pérez (1997) sought to explain differences in banking outcomes in Spain, France, and Italy by linking it to differences in the relative strength of the communist left. The presence of a strong leftist challenge in France and Spain, she argued, forced governments to choose a "soft model of interventionism," whereas the temporary weakness of the left in Italy made possible the use of "direct political control over credit allocation through state ownership of financial institutions" (Pérez 1997:171). Although insightful, the emphasis on left strength, in Pérez's formulation, fails to generalize; the communist left was weak in all European countries but France, Finland, and hypothetically Spain, where its visible manifestation was suppressed, and yet state banking also emerged in Belgium, Norway, the Netherlands, and New Zealand.

More generally, the propositions formulated in the recent literature are induced from a small (and most likely unrepresentative) sample of cases; they are not examined and tested systematically in a true comparative framework. The present paper is an attempt in this direction. Several propositions are derived from a simple model of state-bank relations and tested on a large subset of OECD (Organization for Economic Cooperation and Development) countries.

The argument developed here builds on a simple model of market-government relations. The capital market is subject to scale economies and, if left unregulated, to concentration, with harmful effects for smaller banks and their clients. The government is subject to electoral pressure, with an intensity that varies across countries depending on the nature of the political institutions. Being less wealthy and credit-worthy, but more numerous than the large banks and companies that benefit from market concentration, the smaller banks and their clients have a relatively greater chance to fend off the competition of the large banks through a nonmarket than a market strategy.

If the government is not excessively vulnerable to electoral retribution, at least in the short-term, then the government will be able to resist pressure for banking regulations, offering compensation perhaps under another form. If instead the government is dependent on electoral competition for its short-term survival, then expected losers will succeed in having it regulate the financial market and carve out segments in which small banks can be sheltered from the competition of bigger banks. Segmentation may cut along regional lines, with banks enjoying locational rents, or sectoral lines, with banks catering to specialized clienteles--a bank for small business, a bank for agriculture, a bank for home-owners, and so on. State banking, in its postwar materialization, was a case of sectoral segmentation.

The present model casts light on three aspects of postwar banking. First, state banking developed after World War II, I argue, in response to the rise in power of categories of producers (to whom I will refer as "small capitalists"), who, under normal circumstances, would have been harmed by the play of market forces in the allocation of capital. The small capitalists became a courted bunch when and where the class cleavage became the vehicle for interest articulation. They owed this political windfall to the polarization of the party system along the class cleavage in countries where this party system was not dominated by one party.

Second, the development of state banking in the postwar decades was only one manifestation of the side-stepping of the market; another non-market path was the protection of local banking, still another, the promotion of non-profit banking. Following mainstream institutionalist literature, I argue that the choice of state banking over local or nonprofit banking was determined by the relative degree of centralization of the state. State banking emerged in countries with centralized state institutions (France, postwar Belgium), non-profit banking thrived in countries with decentralized institutions (Germany, Austria), and local banking remained relatively strong in countries with federal institutions (Switzerland, the United States). In all three cases, the large banks saw their growth hampered, losing market share to these other forms of banking. The extent to which large banks fell behind depended on the extent to which small capitalists could exploit the coalitional opportunities afforded by the overarching conflict between labor and capital.

Third, the progressive depolarization of all party systems, which started in the 1960s, gathered momentum in the 1970s, and was completed in the 1980s initiated a shift to a model of mass politics more akin to median voting, which stripped the small capitalists from their postwar leverage, and opened the way for the deregulation of most forms of non-competitive banking, state banking especially.

A first section develops the a-priori notion that capital markets are subject to concentration. The second and third sections derive the identity of the potential losers and map out their nonmarket options. The fourth section develops the class politics hypothesis. The fifth section develops the institutionalist hypothesis. The penultimate section surveys the recent demise of class politics. A concluding sections recalls, and expands on, the findings.

The Secular Trend Toward Market Concentration in Banking

Capital markets, if left unchecked, are subject to oligopolistic concentration. "The development of capitalist industry," wrote Hilferding, "produces concentration of banking..." (1981:223). The reason that he advanced for banking concentration was the parallel concentration of industrial enterprise. A more general reason, I contend, is the depersonalization of banking, which started in the second half of the 19th century, and released the powerful scale economies which today are the hallmark of the banking sector.

Paradoxically, concentration is not an obvious profit-maximizing strategy for bankers. Lending is a risky activity, requiring a relatively uninformed lender to entrust his money with a better-informed borrower. The literature on asymmetric information asserts that, in such conditions, absent trust, transactions fail.[15] This is why banking until the mid-19th century relied on personal connections. Bankers would borrow from, and lend to, individuals whom they knew well, either because they lived in the same towns or because borrowers and bank shareholders were often the same people--a relation that Naomi Lamoreaux has appropriately dubbed "insider lending."[16] Insider lending afforded no economies of scale. One of the largest banking house of the time, the Rothschild's, was a family affair, and banked only with a small coterie of princes and finance ministers.[17]

However, as the benefits of industrialization began to penetrate deeper into the middle strata, the demand for deposit accounts, both short and long, grew to a point that it became conceivable for private bankers to finance lending with deposits taken from numerous individuals with whom they had no prior or other dealings. The depersonalization of deposit taking was only half-of-the-story, however, and would have been insufficient in triggering amalgamation if lending had remained of the "insider" kind. The fact is that the deposit revolution caused a revolution in lending as well. The reason is a bit technical and requires a short detour in the economics of risk.

Banks face two kinds of risk. First, like all businesses, banks face an insolvency risk, which is the case when liabilities grow larger than assets.

[15] Diamond 1984; Williamson 1987.
[16] Lamoreaux 1994.
[17] Gille 1965.

Second, as banks, they face the additional risk of illiquidity; illiquidity is a mismatch between the maturity profile of a bank's resources and that of its assets--assets cannot be realized soon enough to face outstanding claims. Illiquidity may occur if the average maturity of the bank resources becomes shorter, or if that of its assets becomes longer, or both. Both types of risk, furthermore, can either be systematic (a business downturn affecting the economy as a whole) or non-systematic (it is particular to an industry, caused by a labor strike, an obsolete technology, an import shock, etc.).

Individuals in general protect against nonsystematic risk through portfolio diversification. Banks can achieve portfolio diversification by opening branches in multiple regions, offering a different industrial mix. Branching is the first step toward concentration, though a modest one. To guard against systematic illiquidity, in contrast, banks need to specialize, either in short- or long-term banking. The reason is the following. Cyclical business downturns typically freeze assets (the bank cannot sell but at an unacceptable loss) but melt liabilities (actual terms of deposit grow shorter, as depositors get anxious), thereby worsening the mismatch in maturity profiles between the two sides of the balance sheet. The extent of the mismatch depends, of course, on the intensity of the crisis, which is unpredictable, but also on the range of maturity between the most and least liquid assets. Mixing 1-day-long with 1-year-long assets makes the bank more vulnerable to an illiquidity crisis than mixing 1-day-long with 3-month-long or 6-month-long with 1-year-long assets.

Since the middle of the 19th century deposits have been the most important source of cash for banks. Deposits are short-term resources, since even an early-withdrawal penalty scheme would hardly stop a poorly informed, panic-prone depositor confronted with the danger of a bank run from cashing his savings rather than facing the risk of losing them all. Deposit banking forced banks to guard against the risk of illiquidity by specializing in short-term lending.

Short-term lending in turn released powerful scale economies. It allowed for the development of standard lending procedures and, thus, more interchangeable and negotiable instruments, which could be used as secondary forms of liquidity. Lending lost its personal touch, the professionally-trained, appointed-by-the-center branch manager displacing the well-connected and well-informed local banker. Combined with the deposit revolution, the standardization and professionalization of lending opened the way to amalgamation. Amalgamation reduced bank capital requirements, improving earning potential. Amalgamation also allowed merging banks to rationalize their asset portfolio, taking over the best paper held by their competitors and liquidating less desirable items.[18]

Amalgamation naturally led to centralization--the relocation of bank headquarters in financial centers. Centralization allowed banks to capture external scale economies: central clearing permitted banks to economize on working balances while the greater breadth of the market increased the liquidity of security issues.[19] Moreover, centralization permitted banks to enter lucrative lines of activity, such as the underwriting of government and railroad loans. Centralization finally led to internationalization, since among these government loans, figured those to foreign governments, until then the exclusive province of prestigious private banking houses.[20] The upshot was the founding of the gigantic joint-stock banks of today, also known as deposit banks.

Similar trends toward banking are at work today. Various financial services such as savings accounts, mutual funds, and insurance have become

[18] Lamoreaux 1994, 144.
[19] Kindleberger 1978, pp. 72-75.
[20] Bouvier 1968; Cameron 1991, pp. 14-16.

to a large extent close substitutes for each other. As a result, financial institutions, once operating in their traditional segment, have become exposed to new forms of competition from different types of institutions. Disintermediation, a process by which a high-grade borrower issues bonds and commercial paper rather than taking loans while savers invest their bank deposits into mutual funds, is also forcing banks to scramble for new lines of business--riskier ones such as lending to developing countries, to real estate and energy sectors. Disintermediation is also forcing banks to develop fee-generated business, once reserved to investment banks. The spree of bank concentration that has greeted the last twenty years or so of deregulation bears witness to the concentration proclivity of banking, whenever left to its own (market) forces.[21]

In sum, capital markets are subject to concentration. But they are not concentrated for all that. The fact is that concentration has harmful effects for smaller banks and their clients, two constituencies that may appeal to the government to curb concentration. This is the next point.

Potential Losers

Banking concentration has important wealth effects that go beyond the absorption of small banks by larger banks. Nonprofit banks, savings banks especially, stand to lose depositors. Credit cooperatives find it difficult to grow beyond the limited scope of their founding statutes and engage in more lucrative forms of banking. The local banks' clients, the small- and medium-

[21] See Koguchi 1993. It is interesting to note that economists have failed so far to reach a consensus on the existence of scale and scope economies in banking; for a summary of extant research, see Forestieri 1993. This has not stopped bankers from expanding up to the limit allowed to them by extant regulatory frameworks and, whenever they could, to push up these limits as high as possible.

sized firms, which are too large to rely on internal funding, yet not large enough to raise external capital on the equity markets, are hurt by the disappearance of local banks and the center banks' disengagement from long-term lending to industry.[22] More generally, the monopolizing of deposit taking by a handful of risk-averse, center-located banks, each at the head of a countrywide network of branch offices, threatens to drain local districts from individual savings and channel these savings instead into national and foreign government-backed paper. Local governments find it harder to place their paper with local investors while the industrial vitality of regions with a concentration of small- and medium-sized firms is depressed. The circle of potential losers from market concentration further widens with the globalization of finance. Such a globalization, as it existed before 1913 under the gold standard and is currently re-emerging, makes banks less dependent on their national pools of depositors to finance their assets, and less dependent on domestic demand for the selection of such assets. Globalization also subjects states to inefficient competition for capital, high-tax state losing financial business to low-tax states.

Potential victims from market concentration typically try to pursue a nonmarket strategy, involving governmental intervention. Two nonmarket strategies have historically been used in the area of capital market politics: territorial politics and class politics.

Territorial Politics and Class Politics

The articulation of distributional conflicts in capital markets differ from that in labor markets. In most European countries, labor market politics, pit-

[22] The idea (also known as the financial "pecking-order") that firms at different phases in their life cycle present different types of information asymmetry, calling for a different financial instrument, is developed by Lamoreaux (1994) and Calomiris (1995:262).

ting unionized employees against their employers, is *class politics*. Class politics is an instance of categorial politics, emphasizing the functional distribution of societal interests--employers, employees, savers, borrowers, and so on. Capital market politics rarely is categorial politics stricto sensu: we never see savers' associations debating and settling interest rates with borrowers' associations. The reason is that capital, in its saved form, is territorially mobile. It can choose its legal jurisdiction at a cost that is systematically lower than that faced by labor, machines, products, and any other kind of wealth. Of course, a legal jurisdiction may try to curb this mobility through capital border controls. But this is only valid for nation states; local governments cannot regulate flows directly. Even in the case of nation states, making capital captive never is effective, as not all crossborder capital flows should be dammed, especially no those generated by trade and investment.

If savings cannot be captured, they must be courted. If firms want to have access to capital at better conditions than extant market rates, they must convince their local or national government to compete for external capital. Governments can, for instance, subsidize local bank deposits, a measure which has the effect, first, of attracting outside capital, second, of keeping internal capital in, and, third, due to scale economies, of barring entry by outside banks. In countries mandating unit (single-office) banking, Norway and the United States, local governments can directly curb entry by outside banks, thus raising the price of exit for local savers. In addition to subsidizing banks, governments can try to make their own bonds more attractive to outside investors and use the proceeds to subsidize bank lending locally. All these policies target societal interests that are distributed territorially: they try to tap outside savers to benefit local producers. They are products of *territorial politics*.

Although most policies directed toward the capital market are products of territorial politics, there is a significant exception. State banking, a form of banking that redistributes income from taxpayers to industrial sectors, is a case of categorial politics. State banking redefines the distributional conflict from one being between locales to one involving functional actors: small capitalists (grouped into sectors), taxpayers (funding the policy), and working-class parties (supporting the policy). The alliance of working-class parties with the small capitalists, I will show later, was instrumental in developing state banking. Involving sectors, taxpayers, and labor, state banking was an instance of categorial, indeed of class, politics.

Distributional conflicts in the capital markets were allocated according to territorial politics until World War I. Except for Britain, most countries did not start having a modern party system, featuring a competition between freely-elected mass parties, until the turn of the century. In these proto-democratic systems, the partisan (class politics) route was unavailable. Small capitalists could only appeal to their local governments. The territorial route was open, provided, however, that local governments enjoyed regulatory authority over local banking, or political representation in an upper chamber at the national level, or both. This condition was only realized in politically decentralized countries. Only in decentralized countries were nonprofit and local banking sectors able to extract enough subsidies, guarantees, and regulatory obstacles to branching, to check the joint-stock banks' inroad into local deposits.

The regime changes and partisan realignments of the interwar and postwar periods opened up the route of class politics at the national level. In many countries, the unusual mobilization of people and resources that attended the prosecution of World War I, along with the defeat of traditional autocracies, raised voters' political expectations.[23] The appearance on the partisan scene of socialist parties intent on reforming capitalism gave a boost to partisan competition. The rise of the class cleavage and the advent of socialist governments increased the small capitalists' electoral influence and their coalitional leverage.

The small capitalists acquired political influence in party systems that were cleft along the class cleavage and that had strong left governments. There are several reasons for this. The class cleavage, first, created opportunities for groups with no prior affiliation to the working and capitalist classes. Groups of small capitalists, such as farmers, artisans, small merchants and manufacturers, and workers on their own account, who, until then, had been scattered around the party spectrum, in many cases found themselves in the strategically enviable position of arbitrating the electoral competition between capital and labor. The right needed their support to fight the political battles of big business, whereas the left needed their support to stem the tide of nationalist, anti-democratic movements.

In banking matters, second, the working class was the enemy of the small capitalists' enemies--the large capitalists. Since working-class parties could rarely govern alone, they needed the small capitalists' support in order to stay in power. The regulation of the capital market was the ideal terrain of entente between two partners who, otherwise, especially with respect to labor market issues, had little in common.

Third, party systems with strong left parties were polarized, and polarization empowered the small capitalists. Polarization thinned the ranks of unorganized median voters, thereby enhancing the small capitalists' leverage.[24] Polarization, indeed, reflects a bimodal distribution of the elec-

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[23] See Luebbert 1991.
[24] The point was well argued by Samuel Beer's (1982) in his study of 1970s' Britain.

torate, in which the floating center is, if not "empty" as Giovanni Sartori (1976) starkly put it, at least not the most densely populated spot on the partisan continuum. Depolarization, in contrast, describes a case in which voters are normally distributed around the center, with parties converging in their policy offerings to gain support from the densely populated median. In the latter case, often referred to as the median voting model, organized interest groups have their electoral weight diluted within the larger mass of median voters.[25]

More importantly, ideological polarization in some, but not all cases, empowered organized interests at the expense of unorganized ones. In countries where polarization was such that all-out competition was not deemed viable by political elites, lest it destabilize the political institutions, elites sought instead to form a cartel encompassing all organized interests--workers, employers, agrarians and other small capitalists. Government cartels took the forms that have traditionally been analyzed by the consociational literature: grand coalition and Proporz in Austria, multiple executive in Switzerland, and so forth.[26]

Note that, in the spirit of the consociational literature, federalism is a sub-set of polarization. It is a form of cartelization between territorially-defined interests, adopted to mitigate territorial tensions. Moreover, federal systems, as already suggested, do empower small capitalists, given the latter's political entrenchment in local governments. The substantive difference between territorial and class polarization is that only the latter was a response to the rise of working-class movements in the interwar and immediate postwar era; only class polarization would start fading away in the 1960s.

[25] See Downs 1957 on the median voting model.
[26] Lijphardt 1977.

Therefore, keeping aside the federalist case, it is possible to argue that the partisan realignment along class lines that took place during the first half of the century empowered the small capitalists because they were small, well organized, ideologically unattached to the working class or the capitalist right, and available for tactical alliances with working-class parties against large capitalists.

Polarization was a necessary, but not sufficient, condition for the empowerment of the small capitalist classes. Another was the existence of competition, be it all-out or contained through the organization of an encompassing cartel by right and left parties. Competition required that the regime be, first, democratic, and that the party system, second, not be dominated by one party--right and left parties (or coalitions thereof) had to be of roughly equal weight. Spanish autocracy made the small capitalists' electoral support irrelevant, whereas one-party dominance in Japan, Italy, and, to a lesser extent, Sweden and Norway made it somewhat redundant.

Given that autocracy is also a form of monopoly, of the left in communist systems, of the right in the Spanish case, I will treat autocracy and one-party dominance as two instances of partisan monopoly. Autocracy achieves monopoly through the deliberate disfranchising of the opposition, whereas one-party dominance produces the same outcome for purely circumstantial reasons (American diplomatic pressure on Italy during the Cold War, for instance). The opposite of monopoly is proportionality, under which parties enjoy an equitable share of government. Partisan proportionality can be reached either through fair competition or equitable cartelization.

The model yields two testable predictions. The first is the *left hypothesis*. Large, profit-oriented banks should have experienced the greatest setbacks in party systems with strong working-class parties. The second hypothesis is the *monopoly hypothesis*. Large, profit-oriented banks should have experienced the greatest setbacks in party systems that were the least monopolized by a party of the right or the left. The rationale for the monopoly hypothesis is that, in conditions of polarization, monopolistic party systems, in which governmental outcomes reflect neither partisan competition nor encompassing cartelization, are the least likely to empower small capitalists. Note that the two hypotheses point to conflicting effects with respect to the special case of left monopoly. On the one hand, the small capitalists should be advantaged by a left, anticapitalist government. On the other hand, a monopolist left has no need for the small capitalists' support.

The Regulation of Concentrated, Profit Banking: Evidence

This section presents systematic evidence for the left and monopoly hypotheses. The dependent variable measures the asset shares of the four banking sectors. The first banking sector is the concentrated sector, made up of large, branched-out profit-oriented banks. It is the only sector in which banks directly compete with each other and in which the concentration logic discussed above is observable. Competition in the other three sectors is regulated. One is the non-profit sector, made up of savings banks and various forms of cooperatives, including mortgage societies. Another is the state sector, which is composed of postal giro, postal savings, and of state banks. With the exception of postal banks, state banks are usually financed through bonds; they do not take deposits. A last category comprises local, private-oriented banks, chartered by local governments. This category is only valid in the two federal cases of the United States and Switzerland. This breakdown provides a better measure of concentration in banking than the usual indices of concentration. Knowing the market share of the five or ten largest commercial banks, which is usually the kind of information that is revealed by standard concentration indices, reveals concentration in the concentrated sector alone, obscuring the fact that competition in banking operates through the legal segmentation of the market. The most important political debates in banking have borne on the boundaries between these four banking sectors.

Table 1 provides successive snapshots of the relative market shares of each sector for 17 OECD countries in 1913, 1938, 1963, and 1983. The concentrated, profit-oriented sector retreated until the mid-sixties, regaining some of the lost ground thereafter. The decline began in the 1920s, initiated at first by the deflationary policies pursued by all central banks following the inflation of the war and immediate postwar. Making safe placements attractive, deflation reallocated savings from commercial banks to saving banks. Deflation also made it hard for commercial banks to get their advances reimbursed, causing many of them to fail. Instability reinforced the public's renewed attraction for existing state and nonprofit savings banks, worried depositors merely seeking the state guarantee which these sectors enjoyed.

[Table 1]

The regulatory measures that were adopted in the wake of the almost general banking crisis of 1931 accentuated the large banks' relative decline. Drawing the lesson that universal (multipurpose) banks had fared worse than specialized ones, governments tried to tear banks away from universality, through artificial requirements of liquidity rules, reserve requirements, and the separation of deposit from investment banking.[27] The joint-stock banks were cut down to size and their future expansion was contained. While these measures could--and were--defended in the name of greater solvency, they were biased in favor of the non-concentrated banking sector. The U.S. case

[27] Universal bank systems are the opposite of specialized bank systems: in specialized systems some bankers lend long (or, more precisely, are ready to risk the immobilization of their assets), whereas others can only lend short; in universal banking systems, in contrast, banks lend short and long.

is telling in that respect. The unit (single-office) banks suffered the most from the crisis, confirming the well-established fact that single-office banking is a less stable form of banking than branch banking. Yet unit banking in the United States was not only left untouched, but made viable through the creation of the Federal Deposit Insurance Corporation (FDIC), a mandatory insurance scheme for small deposits, equalizing the otherwise unequal illiquidity risk between small banks scattered across rural areas and large banks gathered in financial centers.

These measures were kept unchanged, indeed reinforced, during the postwar decades. The concentrated banking sector kept losing market share to its rivals, except in Denmark and Australia where it increased, and Italy and Canada, where it remained unchanged. A potent mechanism through which governments favored peripheral banking at the expense of concentrated banks during the postwar era was macroeconomic policy. The overall Keynesian orientation of monetary policy in the postwar decades, combined with interest groups' jockeying for rents, had inflationary effects, against which central banks responded by tightening the liquidity constraints of the banks falling under their regulatory rule, that is, mostly commercial banks. Created to avoid another crisis of illiquidity, the liquidity ratios were diverted from their initial goal and used, instead, to contain inflation. Being spared from these restrictions in all countries but Germany, savings banks, credit cooperatives, savings and loans in the U.S., mortgage banks, building societies in the U.K., installment finance companies, state banks, insurance companies, and so forth, expanded their market share at the expense of commercial banks.[28]

The second fact to note, and against which I will test the left and monopoly hypotheses, is the existence of a wide cross-sectional variation in banking

[28] For a good account of the United States, Britain, and Germany, see Kregel 1997:305.

structures. In 1963, for instance, the concentrated, profit-oriented banks controlled 40 percent or more of total banking assets in ten countries (Canada, UK, Spain, Japan, Italy, Australia, France, Belgium, Sweden, Denmark) and less than 40 percent in seven countries (New Zealand, the United States, Norway, the Netherlands, Austria, Germany, and Switzerland) (see Table 1).

The dependent variable is the 1963 percentage share of the concentrated, profit-based banking sector measured in assets. The first hypothesis to test is the left hypothesis--the idea that the cross-national variation was a positive function of the political power of the working class. Measuring the left hypothesis requires the combined use of two variables--one measuring the spatial notion of left, another measuring its content. One can get a spatial notion of the dominant orientation of the government by ranking parties from left to right, then positioning them on a 0-1 ratio scale according to their respective electoral weight, calculating the location of each government, and last averaging over successive governments over the period desired, weighting each government by its duration. The index is included in the regressions as *Right Orientation 1945-1969*. A higher value is associated with a more rightward position on the partisan axis. The index is calculated and reported in the appendix. The variable is available for the period 1945-1969, somewhat overshooting the dependent variable. This index provides a purely spatial definition of left and right without controlling for ideology. British Laborites, Canadian Liberals, U.S. Democrats are equated with Swedish Social-Democrats. The left hypothesis, however, applies to working-class parties in the context of a polarized party system. There is the need, therefore, to control for ideological polarization. Measuring ideological polarization is tricky in the present setup. The presence of a strong communist party, which is the usual proxy for polarization,[29] is undesirable here, for, in the

[29] See for instance Powell 1982.

context of the Cold War, a strong communist presence had the counter-productive effect of empowering the right, not the left--and not the small capitalists either. I settled, instead, for a dummy variable (*Anglo-Saxon*), on the grounds that working-class parties were liberal or laborite in Anglo-Saxon countries but Marxist on the European continent.

The second hypothesis to test is the monopoly hypothesis, according to which the concentrated banking sector's share is a negative function of the degree of monopoly of the political system. Monopoly refers to an inter-partisan distribution of government responsibilities that is not commensurate with the distribution of votes; monopoly is the opposite of fair access to power, whether fairness is achieved through perfect competition or encompassing cartelization. This variable is measured by the extent to which a party's percentage of time in government is disproportionate to its share of the popular vote. Any gross deviation from the strict equality between the proportion of votes and that of time in office indicates a slide toward political monopoly. For example, with 41 percent of the vote on average, the Italian Christian democrats were in government without interruption over the period of the model--1945-1979; after discounting for the fact that the Christian democrats often governed in coalition with other parties, their office share amounts to 84 percent--43 percent above the electoral benchmark of 41 percent. Equivalent figures for the Italian communists are 24 percent and 0.5 percent, yielding a deficit of 23.5 percent for that party. By way of contrast, with 45 percent of the vote, the German Christian democrats had, over the same period, an in-government score of 51 percent--a "profit" of only 6 percent. The corresponding ratios for the German socialists are 37 percent and 33 percent, yielding a deficit of 4 percent only. From these individual party scores, it is possible to construct a systemwide score, which summarizes, for each country, the degree of monopolization of the party system as a whole.

Because in many countries parties do have to take turns in power, the monopoly scale makes sense only if calculated over the long term (1946-December 31, 1979); over a shorter run, the measure would overestimate monopoly in party systems with few parties. 1980 is a timely cutting point, because the late 1970s witnessed a clustering of institutional changes--democratization in Spain, return to partisan competition in France, and partisan realignments in Sweden, Britain, the United States. Special allowances also have to be made for the United States, in light of the presidential nature of the institutions, and for autocratic Spain. The construction of the index is explained in the Appendix; it appears in the regressions as *Political Monopoly 1945-1979.*

There is the need to control for the initial value of the dependent variable. The choice of the date, however, is open to interpretation. The dependent variable is alternatively lagged back to the beginning of the postwar era (*Concentrated Banking 1945*) and the end of the interwar period (*Concentrated Banking 1938*).

Table 2 lists OLS estimates of the model for two specifications, each corresponding to a different lagged value of the dependent variable. In both specifications, all the independent variables are signed correctly but fail to reach basic levels of significance (see regressions 1 and 2). The partial regression plots and the DFITS statistics (unreported) pointed to New Zealand as a clear-cut outlier.[30] Although I have no explanation for why New Zealand should be an outlier, I re-estimated the two regressions including a dummy variable for New Zealand (regressions 3 and 4).[31] The coefficients of the independent variables increase while the corresponding standard errors decrease, allowing the fit of *Political Monopoly* and *Anglo-Saxon* to

[30] On partial regression plots and DFITS statistics, see Bollen and Jackman 1990.
[31] Dropping New Zealand from the sample would produce identical results, except for the F-Value, which, in this particular case, would be superior.

reach comfortable standards of significance. The fit of *Right Orientation* reaches standard level of significance only in the 1938 specification (regression 4).[32]

[Table 2]

In sum, the findings strongly confirm the monopoly hypothesis, but are more ambiguous with respect to the left hypothesis. The radical orientation of the working class is both important and consistently felt across cases, but the mere spatial location on the left of the parties forming the government, even when controlling for radicalism, though important, is perhaps less consistently so. Overall, there is sufficient evidence to confirm the hypothesis that various mixes of fair access to government, left, and Marxism were favorable to the small capitalists, whereas different combinations of monopoly, right, and liberalism or laborism were favorable to concentrated banking.

State Banking and Local-Nonprofit Banking

If the existence of a powerful working class promoted a non-market path, it remains to determine which one. There were three alternatives to concentrated banking: state banking, nonprofit banking, and local banking. State banking is the allocation of credit by state banks, directly or through non-state banks. State banks, which may be owned or not by the state, are usually financed by bonds, held by state savings banks or non-state financial institutions (commercial banks, savings banks, insurances). State banks enjoy borrowing privileges. They are usually specialized (one lends to local

[32] A look at the partial regression plots and a calculation of the DFITS statistics for specifications 3 and 4 pointed, this time, to the United States as a new outlier. Re-estimating the model without the United States strengthened the results in both cases, though insufficiently so to bring the coefficient for *Right Orientation* in regression 3 to a standard level of significance (results unreported).

governments, another to farmers, still another to home owners or small firms, or to firms in need of venture capital, etc.). They were founded to meet a strongly-felt need of credit by a category of borrowers whose relative borrowing power from the capital market is below their political power. A lot of them were set up before and after World War II, with the main purpose of extending medium- and long-term credit to small- and medium-sized business. Instances of such state banks include the Dutch Middenstandsbank (1927) and Herstelbank (1945),[33] the Swedish AB Industrikredit (1934,)[34] the Italian Mediocredito (1952) and the Cassa per il Credito all imprese Artigiane (1947,)[35] the French Crédit National (1919)[36] and Crédit Hôtelier, Commercial et Industriel (1923), the Industrial Finance Department of the Commonwealth Bank (1945) in Australia,[37] the Canadian Industrial Development Bank (1944),[38] the Belgian Caisse Nationale de Crédit aux Classes Moyennes (1937) and Société Nationale d'Investissement (1962),[39] the Spanish Credito Oficial,[40] the Manufacturing Bank of Norway (1936)[41], the British Industrial and Commercial Finance Corporation (1945),[42] the German Kreditanstalt für Wiederaufbau (1948) and Industriekreditbank A.G.-Deutsche Industriebank (1949).[43] The list is far from being exhaustive.

Nonprofit and local banking are two additional specialized forms of banking. Specialization obtains, not along sectoral or class lines as in state banking, but along geographic lines. Both savings banks (to which one would

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[33] See Batenburg, Brouwer, and Louman 1954, 633-38.
[34] See Thunholm 1954, p. 689.
[35] Gerbi 1954, p. 489.
[36] On the Crédit National, see Baubeau, Lavit d'Hautefort, and Lescure, 1994.
[37] Hytten 1954, 35.
[38] Marsh 1954, p. 157.
[39] Van Molle 1995.
[40] Clayton 1962. Pérez 1997.
[41] Knutsen 1995, p.94.
[42] Coopey and Clarke 1995.
[43] Hu 1984, p. 37.

add credit cooperatives and mortgage societies) and locally-chartered commercial banks in effect are local banks, irrespective of their affiliation to central giro mechanisms. They play an important role in providing banking services to regions and classes of producers that are peripheral to the financial center. All these banks benefit from legal privileges that allow them to compete with concentrated banks--savings banks and credit cooperatives typically pay no (or less) taxes, enjoy a state guarantee on their deposits, whereas local banks enjoy a de facto local monopoly, receive transfers from center banks (the U.S. FDIC), or enjoy a local-government guarantee (the Swiss *Kantonalbanken*).

Any of these three forms of banking could serve the electoral purposes of politicians dependent on the support of small business owners: state banking through the creation of still another specialized bank; nonprofit banking by the legislation of regulations tilting market competition in favor of savings banks, mortgage banks, and credit cooperatives; or local banking by further limiting branching. The decision whether they chose to promote one option or the other rested on purely pragmatic grounds, merely sanctioning past development: what was most developed before World War II is what would be further developed after World War II. What accounted then for which non-market path a country would adopt before World War II?[44]

The degree of centralization of political institutions, emphasized by institutionalists like Zysman, is the best answer that I have found. Historically, centralized states (UK, France, Belgium, Japan, the Netherlands) showed an inclination for state banking, less centralized states (Germany,

[44] This is not to say that left governments had no centralizing preferences. Left governments promoted nationally-negotiated wage settlements and a centralizing welfare state. However, these policies were essentially targeted to the labor market. Moreover, even with respect to the labor market, left governments did not try to create a homogeneous labor market by favoring labor geographic mobility, but by bringing work to the workers through policies of regional development financed through the tax base.

Austria, Italy, Sweden, Denmark), for nonprofit banking, and fully decentralized, federal states (the United States, Switzerland), for local banking.[45] The reason, I surmise, laid in the conflicts that accompanied the process of state formation. State treasuries were the largest capital borrowers; as Colbert's comparison of bankers with soldiers vividly suggests, they had a vested interest in marshalling capital markets to their benefit and to the extent of the regulatory power that they possessed. The extent of this regulatory power depended on the presence of other potential borrowers and their respective power. The most consistent opponents of central treasuries' efforts to widen the circulation of state debt were local governments, who sought to retain local capital for their own use and for local investment.

The dominions constitute a special case, however, in which the organization of the capital market was simultaneous, if not prior, to the organization of the state. Also, the dominion capital market structures reflected British influence. Bank charters were submitted for approval to the government in London before autonomy. This historical circumstance is responsible for an unusually centralized capital market structure common to all dominions: branch banking was legal across Canadian provinces and across Australasian states, irrespective of federal institutions in Canada and Australia and unitary in New Zealand.

Table 3 provides OLS estimates of the state-centralization model. The dependent variables respectively are the market shares of state banking (regressions 1 and 2) and of local and nonprofit banking combined (regressions 3 and 4), once again measured in 1963 assets. Local banking is combined with nonprofit banking in equations 3 and 4 in order to keep the test

[45] There were exceptions to this generalization. Spain had a centralized state and yet had no state banking in 1913; Norway had a semi-centralized state, and yet a significantly large state banking sector in 1913. For more on this point, see Verdier 1996.

tractable; combined with local banking, nonprofit banking is expected to be a negative linear function of state centralization, whereas alone it could also well be an inverted-U function of state centralization.[46] The institutional variable (*Tax Centralization 1880*) is a tax proxy of state centralization--the share of the central government in the appropriation of all taxes levied in the nation circa 1880. It is a suitable proxy because, like banking, it bears on states' never-ending need for cash, yet with a priori no known relation with banking. No data prior to 1880 could be found (see appendix). Since I have no special expectation as to how the dominions, each one or as a group, should behave in the state-centralization model, they are excluded from the sample. The test controls for the lagged value of the dependent variable. I chose the years 1938 and 1913, preceding each war, to avoid incorporating the shocks of war on state banking.[47] Controlling for an earlier value of the dependent variable is also desirable for an argument about institutional path dependence.

[Table 3]

The findings offer tangible confirmation that the type of non-market path was a function of state centralization. The coefficient of the independent variable (*Tax Centralization*) is correctly signed and significant across specifications. Testing for outlying DFITS values found none in regressions 1 and

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[46] The expected shape of the curve would depend on whether local governments in federal states (Switzerland and the United States), when exercising the right to charter local banks, have a preference for commercial banks or nonprofit banks; if they all prefer commercial banks, then the relation betwen nonprofit banking market share and state centralization is an inverted-U curve; if, on the contrary they all prefer nonprofit banks, then the relationship is a declining linear function; if they differ in preference, or have no particular preference, then the expected curve is heteroscedastic. Combining local with nonprofit banking is also justified in light of the rare occurrence of local banking; only two countries had locally-chartered banks throughout the 19th and 20th centuries--the United States and Switzerland--making testing superfluous. A third country, Australia, also had local banking on the order of 3 percent of total assets. The insignificance of Australian local banking, along with the difficulty in gathering data in any consistent way thereon, led me to dismiss Australian local banking from the dataset.

[47] The 1945 values for *State Banking* were considerably inflated by World War II; for half of the cases, the 1945 value is superior to the 1963 value for no other reason that banking was made difficult by the war.

4, but the Netherlands in regression 2, and the U.S. in regression 3. Dropping the outliers from their corresponding regression weakened the coefficient and the fit for the variable *Tax Centralization* (results unreported). Therefore, there is substantial, though not overwhelming, evidence that the choice of nonmarket path in the postwar era followed a logic of path dependence.

One can say, to summarize the findings of the last two sections, that the relative political power of the small capitalists explains the extent to which the nonmarket path was pursued after World War II, while state institutions explain the type of non-market path favored in each country.

The Return to the Market Path

The picture we drew for the postwar era is no longer valid today. State banking has lost ground to other forms of banking everywhere except in Germany, where it is stable, and in Japan, where it has risen sharply. The relative share of concentrated banking is up dramatically (except in the United States and Norway where it is about the same, and Denmark, Spain and Japan, where it has declined). Local and nonprofit banking are relatively stable, except for a sharp drop in Britain and sharp increases in Spain and Japan.

This recovery of the concentrated, profit-oriented banking sector, which is presently happening in most countries, has been attributed to the simultaneous deregulation of banking and the globalization of finance.[48] This is not the place to assess the validity of this claim. But, be they cause or effect, deregulation and openness could only occur along with a revolution in

[48] See Andrews 1994, Cerny 1995, Frieden and Rogowski 1996, Goodman and Pauly 1993, Helleiner 1994, and Webb 1991.

the political economy of postwar banking--the political weakening of the small capitalists. Moreover, there is considerable variation around the trend, and no explanation is persuasive that cannot account for it. The current changes observable in banking markets, I argue, are coterminous with the decline of class politics and the re-emergence of territorial politics.

Distributional conflicts in the 19th century, I argued earlier, were allocated according to territorial politics--a policy process that favored the banks and the firms that were located in powerful jurisdictions. In centralized countries, the geographic qua financial center played that role, whereas in less centralized countries, financial peripheries could also claim a share of the spoils. The more decentralized a country's state institutions were, the more regulated and fragmented the capital market was. The interwar era superposed a second policy process--class politics. Class politics generalized the distributional cleavage governing labor markets to the party system. Class politics obtained where the party system was equally split between a working-class bloc and an employer bloc, with each side enjoying an about equal chance of governing. The left-right competition could be overt and all-out or, given the risk of polarization, contained through consociational devices or corporatist bargaining. Class politics gave the losers of the geographically-cleft capital market new opportunities to circumvent market concentration. By allying with the left, or merely threatening to do so, the small capitalists were able to extract regulatory rents from the central government. State banking especially flourished in countries like France, postwar Belgium, and the Netherlands, where state centralization had traditionally foreclosed the local government route to small capitalists. In less centralized countries, class politics merely helped consolidate the territorial rents for local and non-profit banking achieved before World War I.

Class politics did not last. The embourgeoisement of the working class, the inability of Keynesian macroeconomic policies to deal with the price shocks of the seventies, and various other reasons triggered a right shift by the voters and the parties representing them. Left and right governments began to pursue the pro-market policies advocated by the neo-liberal right. The collapse of the Soviet Bloc lifted off all semblance of partisan polarization. Electoral politics became a specie of Downs' (1957) median voting model, with voter normally distributed, a sizable floating vote, and the policy orientation of successive governments differing only at the margin.

The first rents to be sacrificed to this new economic experiment were those enjoyed by the small capitalists, as it was politically easier to dismantle rents in the capital market than in the labor market. More specifically, among the three forms of sheltered banking--local, nonprofit and state--state banking was the most negatively affected; state banks lost their borrowing privileges. State banking was the most negatively affected because it owed its existence entirely to class politics. In contrast, local and nonprofit banking, which had pre-existed class politics, better withstood the collapse of class politics.

The present discussion yields a testable proposition: the recent surge in concentrated banking was more marked in countries with more state banking. These were, first, the countries with moderate or low levels of state centralization, in which the existing fragmentation in favor of local and nonprofit banks antedated the advent of class politics. These were, second, the countries which, even though they had centralized state institutions, had little state banking to shed (Spain and Japan), because they had been governed by right monopolies during the postwar era, a form of government that was unsympathetic to small capitalists' rents.

Table 4 presents OLS estimates for the decline-of-state-banking model. The dependent variable is the relative asset share of the concentrated banking sector in 1983. The first independent variable is the asset share of the state banking sector in 1963 (*State Banking 1963*). The expected relation is positive: the larger state banking was in 1963, the larger concentrated banking should have become in 1983. Conversely, one would expect a negative relation of the same magnitude between local-nonprofit banking in 1963 and concentrated banking 1983. In other words, the larger local-nonprofit banking in 1963, the smaller concentrated banking in 1983. The second independent variable (*Right Monopoly 1945-1979*) is an interaction term: the product of the monopoly index with the spatial position of the government on the left-right axis. Both indices were recalculated to cover the period 1945-1979. The control variable is the 1963 value of the dependent variable (*Concentrated Banking 1963*).

[Table 4]

The results conform with our expectations: both independent variables are signed correctly and meet standard levels of significance. Since both variables, *Concentrated Banking 1963* and *State Banking 1963*, have a positive sign, therefore *Local & Nonprofit Banking 1963* has, by way of definition, a negative sign of equivalent magnitude and significance than *State Banking 1963* (results unreported). A sensitivity analysis (DFITS) detects three outliers (Britain, Italy, Japan, and New Zealand). The re-estimated model without these three observations not surprisingly shrinks the coefficient for the variable right monopoly--Italy and Japan were two of the three right monopolies (the third being Spain). Coefficient and fit for the *State Banking* variable, however, are robust.

The demise of class politics brings capital politics back to its pre-1914 pattern. Distributional conflicts between credit institutions were adjudicated back then within the broader rivalry between center and periphery; strong local governments could enable small banks and their clients to fend off absorption or competition from larger predators, whereas weak local jurisdictions could not. Features of the past are re-emerging. The deregulation of finance and the freeing of cross-border flows make local and regional communities important again. Privatization, along with the opening of national markets, frees up scale economies, which market actors seek to capture by becoming transnational; savers and firms invest abroad. The typical state's response in Europe has been to devolve regulatory powers which, until then, were exercised by national local governments, to the European Commission. Simultaneously, budget constraints have forced central governments to compress the sums traditionally devoted to regional development policies, with local and regional communities left to bear the burden of change. Local communities are pressed to make themselves attractive to savers and firms, both local and external. Regions are increasingly locked into a race of which the winners may well be those that, in addition to their natural resources, have the most policy instruments at their disposal.[49] The German and Italian industrial districts, along with the much acclaimed Silicon Valley, have become the models to emulate. The upshot is an intensification of regionalism. Demands for devolution downward are aired from every corner of Europe, leading three of the most centralized governments (Spain, France, and Britain) to engage on the road of institutional decentralization.[50]

However, centralized states, except perhaps for Spain and Belgium, will most likely remain centralized, making it hard for their local banks and industries to face the shock of financial globalization. This time, however,

[49] See Keating 1997.

[50] Note that these decentralizing reforms were the doing of left governments, a move that, in light of the present analysis, may be interpreted as the continuation, or re-creation, of the postwar alliance between the left and small and locally-based businesses.

the potential losers of financial globalization will have no other choice but to play by the rules of the capital market, viz. absorb or be absorbed.

Conclusion

The tactical alliance between small- and locally-based business, on the one hand, and the parties of the working class, on the other hand, begat state banking. The state assumed the role of creditor in countries where the alliance was strong, especially so in those with centralized state institutions (France, postwar Belgium, the Netherlands, and New Zealand), in which local governments lacked the regulatory power that would have allowed them to come to the help of small, local capitalists. The tactical alliance between left and small capitalists was the product of a particular period, the interwar and postwar years, and a specific place, continental Europe. The party system of these countries was cleft along, and polarized by, the class cleavage, thereby placing small capitalists in the enviable position of arbitrating the conflict between the capitalist right and the working-class left. In the few cases where the partisan balance was ruptured in favor of one side, as such was the case in autocratic Spain and Christian-Democratic Italy, the small capitalists had much less leverage and were unable to extract state banking.

State banking was an exceptional and ephemeral form of state intervention in the allocation of credit. It was the product of a unique set of circumstances, not of any logic internal to the capital market. State intervention in the capital market, when any, takes the more usual route of local banking, be it in the overt form of locally-chartered, locally-regulated banks or in the more occult, yet not less effective, form of nonprofit banking. The banking sector is segmented along geographic lines because local savings, when tapped by the branch of a money center bank, can travel almost anywhere within the country or abroad. Local governments, in contrast, are kin to see local savings invested in local projects and seek to that effect to promote local banks. In all countries but France, Britain, and, to a lesser extent, Belgium, New Zealand, and the Netherlands, incomplete state-building provided local governments with the regulatory means to fragment the market for capital along territorial lines. Local and nonprofit banking were dominant in decentralized countries before World War I; they remained important during the heyday of state banking; they are still important today, after the parting of state banking.

The demise of state banking marks the end of an epoch. State banking was the product of class politics, redefining all issues around the employer-employee cleavage, a template borrowed from the labor market. Labor market considerations, such as full employment, reigned supreme from the 1930s until the neo-liberal revolution of the 1970s. Enthroning price stability, the neo-liberal revolution emancipated the capital market from its prior subordination to the labor market. It may have also turned the tables against the labor market. Territorial politics is once again the modus operandi in the capital market and, to the extent that more labor conflicts are decentralized to the local level, in the labor market as well.

The demise of state banking may take us a century back, to a time when the countries that were the most dependent per capita on cross-border capital flows were those that were the most politically centralized, irrespective of whether they were net creditor, like Britain, France, and the Netherlands, or debtor, like Canada and Australasia.[51] Global overstretch in those countries eventually gave rise to the so-called Macmillan gap, referring to the conclu-

[51] See Verdier forth.

sion reached in 1931 by an eponymous British parliamentary committee that the financial market failed to provide long-term finance to small and medium firms.

APPENDIX

[Table 5]

<u>Political Monopoly</u>

In an ideal electoral system, a party's length of stay in government should be proportional to its share of the popular vote. The further away is a party from this equilibrium, the more monopolistic the party system. The index calculates for each party the difference between the average electoral score

$$\sum_{t=1}^{T} \frac{1}{T} \frac{V_{it}}{V_t} ,$$

with V_{it}, party i's total votes at year t (for years without elections, I ued the prior election-year results),

V_t the total number of votes cast at year t (same qualifier),

T the number of years,

and the number of years in government (weighted by the relative electoral weight in the coalition in the case of a coalition government)

$$\sum_{t=1}^{T} \frac{1}{T} G_{it} \frac{V_{it}}{V_{gt}} ,$$

with V_{gt}, the number of votes received by the parties forming the coalition government at year t (same qualifier as for V_{it}),

G_{it} = [0,1] depending on whether party i at time t is part of the government ($G_{it}=1$) or not ($G_{it}=0$),

for the period starting in 1945 or 1946, depending on when the first elections were held (but no later than 1946), and ending December 31, 1979.

Party indices in each country sum up to 0, because one party's surplus is another's deficit. By taking the absolute value of each party's score, and adding them, one gets an aggregate value that reflects the distance between share and profit for the party system as a whole ($M \in R$: $0 \leq M \leq 1$).[52] The formula for a country's party system monopoly index is

$$M = \sum_{i=1}^{N} \left| \sum_{t=1}^{T} \frac{1}{T} \left[\frac{V_{it}}{V_t} - G_{it} \frac{V_{it}}{V_{gt}} \right] \right| .$$

To take into account the peculiarity of the U.S. case (presidential, with several occurrences of divided government), I made two assumptions: (1) there exists four parties: republican congressional, republican presidential, democratic congressional, and democratic presidential (dividing their actual results by half so that the V_{it}/V_t ratios add up to unity); (2) all governments are coalition governments that include a congressional party and a presidential party. To take into account the peculiarity of the Spanish case (dic-

[52] I prefer to use absolute values rather than the more mathematically correct Euclidian distance between share and profit in an N-dimensional space, with N representing the number of parties (Verdier 1995). The distribution obtained by means of the latter procedure, although no different from the one generated through absolute values in terms of country ranking, has a longer tail, making it less appropriate for OLS analysis.

tatorship), I assigned to each year of dictatorship the highest *M* score recorded among other countries.

Government Partisan orientation (RIGHT)

The index of partisan orientation of the government is an average calculated over two periods: January 1, 1945-December 31, 1969 and January 1, 1945-December 31, 1979. The index was calculated, first, by assigning to each party a positive integer i ($i \epsilon Z^+$) according to the ordinal pattern: 1 to the most leftist party, 2 to the next to the most leftist, and so on, until all parties are ordinally arranged on a left-right axis. Each i was then assigned a positive real number p_i ($p_i \epsilon R$: $0 < p_i < 1$) to reflect each party's share of the electorate, according to the formula:

$$p_i = \frac{r_i}{2} + \sum_{j=0}^{i-1} r_j,$$

with r_i, party i 's percentage of votes, and j an integer representing the parties on the left of i, with $0 \leq j < i$, and $r_j = 0$ if $j = 0$.

Last, the government orientation index p_g ($p_g \epsilon R$: $0 < p_g < 1$) was calculated by averaging the p_i's for those parties in government at any point during the covered period:

$$p_g = \frac{1}{T} [\sum_{t=1}^{T} \sum_{i=1}^{N} (p_{it} * G_{it})],$$

with G_{it} = [0,1] depending on whether party i at time t is part of the government ($G_{it}=1$) or not ($G_{it}=0$),

T the number of years,

N the number of parties.

To take into account the peculiarity of Spain who experienced years of rightist dictatorship, I assigned to each year of dictatorship the highest p_g score among other countries.

The generic source for electoral scores and government composition is *Keesings'*.

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Table 1 : Asset Market Shares of the Four Banking Sectors

	1913				1938			
	I	II	III	IV	I	II	III	IV
UK	0.79	0.09	0.12	0	0.60	0.22	0.17	0
Canada	0.77	0.20	0.03	0	0.85	0.14	0.01	0
Japan	0.74	0.12	0.14	0	0.63	0.13	0.24	0
Spain	0.74	0.26	0	0	0.65[h]	0.17[h]	0.17[h]	0[h]
Sweden	0.67	0.32	0.01	0	0.49	0.45	0.06	0
Australia	0.66	0.33	0.01	0	0.51	0.29	0.20	0
Belgium	0.56	0.03	0.41	0	0.40[f]	0.01[f]	0.59[f]	0[f]
Italy	0.51	0.34	0.15	0	0.41	0.34	0.25	0
France	0.50	0.06	0.44	0	0.38[e]	0.06[e]	0.55[e]	0[e]
Norway	0.49	0.37	0.14	0	0.32	0.46	0.23	0
New Zealand	0.48	0.10	0.42	0	0.36[e]	0.12[e]	0.52[e]	0[e]
the Netherlands	0.47	0.42	0.11	0	0.39	0.39	0.22	0
USA	0.42[a]	0.18[a]	0[a]	0.40[a]	0.35	0.20	0.14	0.31
Austria	0.37[b]	0.60[b]	0.03[b]	0[b]	na	na	na	na
Denmark	0.29	0.71	0	0	0.28	0.72	0.01	0
Switzerland	0.26	0.29	0.01	0.43	0.24	0.23	0.01	0.52
Germany	0.25	0.75	0	0	0.14	0.81	0.05	0

	1963				1983			
	I	II	III	IV	I	II	III	IV
UK	0.57	0.26	0.17	0	0.84	0.13	0.03	0
Canada	0.76	0.23	0.01	0	na	na	na	na
Japan	0.58	0.23	0.19	0	0.32	0.36	0.32	0
Spain	0.65	0.21	0.14	0	0.62	0.09	0.29	0
Sweden	0.41	0.48	0.11	0	0.50	0.48	0.02	0
Australia	0.70	0.13	0.14	0.04	na	na	na	na
Belgium	0.40	0.06	0.54	0	0.68	0.07	0.25	0
Italy	0.51	0.35	0.14	0	0.61	0.35	0.40	0
France	0.43	0.06	0.51	0	0.52	0.09	0.39	0
Norway	0.33	0.35	0.32	0	0.33	0.35	0.32	0
New Zealand	0.29	0.16	0.55	0	0.67	0.17	0.16	0
the Netherlands	0.34	0.32	0.34	0	0.54[c]	0.27[c]	0.19[c]	0
USA	0.35	0.33	0.04	0.28	0.37	0.32	0.06	0.25
Austria	0.34[g]	0.54[g]	0.12[g]	0[g]	0.38	0.54	0.08	0
Denmark	0.44	0.52	0.04	0	0.39[d]	0.61[d]	0[d]	0[d]
Switzerland	0.36	0.20	0.04	0.40	0.56	na	0.02	na
Germany	0.21	0.67	0.12	0	0.22	0.69	0.10	0

I *Concentrated banking sector*: commercial banks regulated by the central government.

II *Nonprofit banking sector*: savings banks, mutual credit societies, mortgage banks.
III *State banking sector*: postal savings, all or part of the savings banks in France and Belgium, government and semi-public banks.
IV *Local banking sector*: commercial banks regulated by local governments, such as State banks in the United States, and local and cantonal banks in Switzerland. The four sectors add up to unity.

[a] 1912.

[b] Austria and the Czech Lands.

[c] 1984.

[d] 1980. Data for postal transfers are unavailable.

[e] 1937.

[f] 1939.

[g] 1960.

[h] 1935.

Sources: Goldsmith 1969, completed with, for Australia: Butlin, Hall and White, 1971; White 1973; Official Year Book of Australia. Austria (ustria and the Czech Lands in 1913): Mitchell 1992, 774, 781; Statistiches Jahrbuch; Österreichische Nationalbank; Diwok 1982. Belgium: Société des nation 1931, 116; Mitchell 1992, 781, 784; Annuaire statistique de la Belgique; OECD. Canada: Société des nations 1931, 329; Canadian Yearbook. Denmark: Société des nations 1931, 125; Johansen 1985. France: Mitchell 1992, 774, 782; Bayliss and Philip 1980, 127; Banque de France; Conseil National du Crédit. Germany: Deutsche Bundesbank 1976; Statistisches Jahrbuch für die Bundesrepublik Deutschland. Italy: Mitchell 1992, 774, 782; Société des nations 1931, 187; Garofalo and Colonna 1997; Banca d'Italia a, b. Japan: Tamaki 1995, 223-36; OECD. The Netherlands: Nederlandsche Bank 1987, 34, 48, 52; OECD. New Zealand: Société des nations 1931, 447; New Zealand Official Yearbook; Bloomfield 1984. Norway: Société des nations 1931, 199; Mitchell 1992, 782; Statistisk Arbok. Spain: Martin-Aceña 1995, 522; Mitchell 1992, 782; OECD; Banco de España 1986, 1996. Sweden: Société des nations 1931, 275; Mitchell 1992, 783; Statistisk Arsbok för Sverige; Sveriges Riksbank 1971; Bankaktiebolagen Fondkommissionärerna Fondbörsen och VPC. Switzerland: Société des nations 1931, 288; International Monetary Fund 1962; Ritzmann 1973; Schweizerische Nationalbank. U.K.: Société des nations 1931, 260; Sheppard 1971; Annual Abstract of Statistics. U.S.A.: Société des nations 1931, 346; Mitchell 1983, 775, 785; Statistical Abstract of the United States; U.S. Bureau of the Census 1975; Board of Governors of the Federal Reserve System a, b, 1943, 1959.

Table 2: OLS Estimation of the Left and Monopoly Hypotheses
Dependent Variable: Asset Share of the Concentrated Banking Sector in 1963

	expected sign	1	2	3	4
Constant	+/-	-0.04	-0.01	-0.05	-0.05
		(-0.33)	(-0.13)	(-0.50)	(-0.65)
Concentrated Banking 1945	+	0.73		0.37	
		(3.57)***		(1.56)	
Concentrated Banking 1938	+		0.65		0.43
			(3.92)***		(3.30)**
Political Monopoly 1945-1979	+	0.11	0.11	0.26	0.22
		(0.90)	(0.97)	(2.14)*	(2.62)**
Right Orientation 1945-1969	+	0.11	0.21	0.26	0.31
		(0.56)	(1.20)	(1.50)	(2.51)*
Anglo-Saxon	+	0.03	0.04	0.15	0.13
		(0.53)	(0.63)	(2.07)*	(2.83)**
New Zealand	+/-			-0.25	-0.26
				(-2.29)*	(-3.62)***
R^2		0.79	0.81	0.86	0.92
Adj. R^2		0.71	0.74	0.79	0.88
F-Value		$F(4,11)=10.17$	$F(4,11)=11.57$	$F(5,10)=12.30$	$F(5,10)=22.05$
s. e. r.		0.0840	0.0798	0.0714	0.0551
N		16[a]	16[a]	16[a]	16[a]

Notes:
* $p<0.10$, two-tailed test.
** $p<0.05$, two-tailed test.
*** $p<0.01$, two-tailed test.
Values of *t*-statistics in parentheses.
[a] Australia, Austria, Belgium, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, United Kingdom.
Sources. *Concentrated Banking 1938*, *1945*, and *1963* (the dependent variable): Table 1. *Political Monopoly 1945-1979* and *Right Orientation 1945-1969*: Table 5. *Anglo-Saxon* is a dummy variable for Australia, Canada, New Zealand, the U.K., and the U.S.A. *New Zealand* is a dummy variable for New Zealand.

Table 3: OLS Estimation of the State-Centralization Model

Dependent Variable	Asset Share of					
		State Banking 1963			*Local & Nonprofit Banking 1963*	
	expected sign	1	2	expected sign	3	4
Constant	+/-	-0.10 (-1.28)	-0.07 (-0.92)	+/-	0.38 (3.32)***	0.44 (3.14)**
State Banking 1938	+	0.71 (5.57)***				
State Banking 1913	+		0.85 (5.82)***			
Local & Nonprof. Banking 1938				+	0.56 (6.14)***	
Local & Nonprof. Banking 1913				+		0.52 (4.58)***
Tax Centralization 1880	+	0.003 (1.86)*	0.003 (2.22)*	-	-0.004 (-2.78)**	-0.004 (-2.59)**
R^2		0.89	0.90		0.94	0.91
Adj. R^2		0.87	0.88		0.93	0.89
F-Value		$F(2,9)=37.87$	$F(2,9)=40.88$		$F(2,9)=72.98$	$F(2,9)=47.77$
s. e. r.		0.0637	0.0616		0.0546	0.0682
N		12[a]	12[a]		12[a]	12[a]

Notes:
* $p<0.10$, two-tailed test.
** $p<0.05$, two-tailed test.
*** $p<0.01$, two-tailed test.
Values of *t*-statistics in parentheses.
[a] Belgium, Denmark, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, United Kingdom.
Sources. *State Banking 1913*, *1938*, and *1963* (dependent variable) and *Local & Nonprofit Banking 1913, 1938*, and *1963* (dependent variable): Table 1. *Tax Centralization*: Table 5.

Table 4: OLS Estimation of the Decline-of-State-Banking Model
Dependent Variable: 1983 Asset Share of the Concentrated Banking Sector

	expected sign	
Constant	+/-	0.02
		(0.11)
Concentrated Banking 1963	+	1.35
		(3.14)**
State Banking 1963	+	0.45
		(2.34)*
Right Monopoly 1945-1979	-	-0.61
		(-2.06)*
R^2		0.54
Adj. R^2		0.42
F-Value		$F(3,11)=4.30$
s. e. r.		0.1280
N		15[a]

Notes:
* $p<0.10$, two-tailed test.
** $p<0.05$, two-tailed test.
*** $p<0.01$, two-tailed test.
Values of *t*-statistics in parentheses.
[a] Australia, Austria, Belgium, Denmark, France, Germany, Italy, Japan, the Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, United Kingdom.
Sources. *Concentrated Banking* and *State Banking*: Table 1. *Right Monopoly 1945-1979* is the product of *Right 1945-1979* and *Political Monopoly 1945-1979*; both variables are from Table 5.

Table 5: Dataset

	Tax Centralization c. 1880 %	Political Monopoly 1945-79	Right Orientation 1945-69	Right Orientation 1945-1979
Australia	25	.66	.69	.67
Austria	na	.25	.56	.56
Belgium	85	.35	.56	.55
Canada	75	.76	.45	.44
Denmark	64	.61	.41	.42
France	83	.72	.64	.65
Germany	49	.22	.61	.49
Italy	55	.89	.64	.65
Japan	na	.88	.68	.70
Netherlands	87	.38	.56	.56
New Zealand	60	.53	.63	.62
Norway	60	.75	.38	.38
Spain	79	.89	.68	.68
Sweden	64	.83	.30	.34
Switzerland	37	.36	.57	.55
U.K.	70	.22	.51	.50
U.S.A.	33[a]	.21	.45	.45

[a] 1902.

Note and Sources. *Political Monopoly* and *Right Orientation*: Appendix. *Tax Centralization* is central government taxes as percentage of general government taxes circa 1880; for Western Europe, excluding Spain, Flora (1983, p. 273); data for Austria could not be used, for excluding the non-Austrian part of the Empire; for Spain, Bernis (1919, 338, 347); for the United States, U.S. Bureau of the Census (1975, p. 1119); for Canada, Canada Department of Agriculture (1890, 104, 117); data for Australia are for 1907 (Mitchell 1983, 802; Commonwealth Bureau of Census and Statistics 1908, 668); data for New Zealand are for 1913 (Bloomfield G. T. 1984, 333, 352).

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